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UNCLAS SECTION 01 OF 03 CARACAS 000216

SIPDIS

SENSITIVE
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TREASURY FOR KLINGENSMITH AND NGRANT
COMMERCE FOR 4431/MAC/WH/MCAMERON
NSC FOR DTOMLINSON
HQ SOUTHCOM ALSO FOR POLAD

E.O. 12958: N/A

TAGS: ECON EFIN PGOV VE

SUBJECT: ROBIN HOOD WAS A SOCIALIST

REF: A. 06CARACAS 3434

- 1B. 06CARACAS 3617
- 1C. 06 CARACAS 3653
- 1D. CARACAS 183

SUMMARY

11. (SBU) During the past two weeks Chavez and other BRV officials have proposed a dizzying array of tax increases, all of which Chavez will have the ability to impose through decrees sanctioned by the new "enabling" law. These proposals maintain the trend of growing the tax burden on individuals and private companies and even greater government imposition on the private sector. In proposing to increase taxes on assets, luxury items, and gasoline, as well as limiting hard currency authorizations to restrict imports and favor domestically produced goods, the BRV is adding to strong inflationary pressures and distorting the economy further in its march towards 21st century socialism.

IF 10 PERCENT IS GOOD ENOUGH FOR THE CHURCH...

12. (SBU) During his weekly "Alo Presidente" call-in show on January 21, Chavez took some time to lambaste bank profits and wealthy individuals in Venezuela. Referring to luxury property, Chavez suggested that the BRV would institute an assets tax, demanding a percentage of peoples' assets. He threatened, "you have a BMW, well okay...a tax. You have a home and another on the sea...come here buddy. You have an airplane...collections of marvelous art, come here buddy..." According to Chavez, the proceeds from this tax would go to community councils. The Venezuelan tax authority, SENIAT, explained that such an asset tax would only affect people with net worths in excess of 560 million Bolivars (or USD 260,000) and that the rate would range from .5 to 1 percent of assets. (COMMENT: As Chavez correctly noted, France does have an asset tax of .7 percent, though very few countries in the world have been successful in collecting such a tax. Despite significant improvements in collection by SENIAT, tax evasion remains a competitive sport here and it is very unlikely that the government would be successful in getting anything near an accurate accounting of individuals' net

worth, especially given that most Venezuelans with enough money to buy a BMW have learned how to hide their assets domestically and abroad. END COMMENT.)

¶13. (SBU) In addition to the increase in duties for luxury goods (reftel C), the BRV is also contemplating additional luxury taxes, which may come in the form of a separate value-added tax (IVA), or in an increase in the IVA rate for certain goods. (Note: Currently, almost all goods in Venezuela are subject to 14 percent IVA. Notable exceptions include certain foodstuffs and educational and medical supplies. End Note.) According to the daily El Universal, a tax on "selective consumption" may include alcohol, cigarettes, cell phone, internet, and television service.

¶14. (SBU) SENIAT recently announced that they would tax idle agricultural lands and threatened possible expropriation if this did not encourage land holders to use their lands for agricultural production. At the same time SENIAT recently announced up to a two year tax holiday on agricultural production. National and local governments have already expropriated "idle" rural and urban holdings, so a tax holiday would represent an odd method by which the BRV is attempting to stimulate domestic production without resorting to more traditional methods like improving the investment or judicial climate.

USURY AND OTHER TERMS

¶15. (SBU) Chavez has also begun to attack what he considers "tiny," or "chiquitito" taxes paid by banks. The corporate income tax is 34 percent. However in the second semester of 2006, the banking sector only paid on average 8.7 percent of

CARACAS 00000216 002 OF 003

its income in taxes. This is because most banks in Venezuela are heavily invested in government bonds and CDs, which are tax-free. Banks have profited by paying 6 percent to depositors and earning 10 percent on those investments (the rate paid on government CDs and bonds). However, according to one sector contact, most profit growth in recent years has been through the increase in consumer credit and investing. Increasing taxes on bank income, or "excessive" profits, fits with BRV rhetoric regarding the private sector, in general. It seems increasingly likely that Chavez will move to cap profits in the private sector, at which point one banking contact joked that they would make as much as the BRV allowed and use the leftover money to raise their salaries.

WATER INTO GAS

¶16. (SBU) Venezuela has the cheapest gasoline in the world (17 cents a gallon) and gas prices have not changed since Chavez took office in 1999. Various estimates put PDVSA's losses from gasoline subsidization at anywhere from USD 1 to 4 billion annually, and the heavily subsidized gas creates many negative externalities, including contributing to Caracas's gridlock (reftel B). Venezuela is consuming around 280,000 barrels daily of gasoline. The opportunity cost of selling it at 17 cents a gallon instead of the world pump price of about USD 2 a gallon is in the tens of billions of dollars (see reftel D for more details). Despite the economic reality, Venezuelans are incredibly attached to essentially free gas and it remains to be seen if Chavez will follow through. He has already claimed that any increase would avoid certain sectors of the economy like transportation. In 1989 government attempts to raise gas prices led to massive rioting, hundreds of deaths and supposedly inspired Hugo Chavez to begin plotting his coup.

MONEY CHANGING IN THE TEMPLE

17. (SBU) The parallel exchange rate for dollars is hovering around the 4200Bs./dollar mark, making the Bolivar approximately 95 percent overvalued as compared to the official rate of 2150Bs./dollar. Increasing limitations on what goods are eligible for CADIVI dollars (the official rate) have pushed more importers to use the parallel market to bring their items into Venezuela, which has contributed to inflation (see reftel A), and exacerbating the capital flight generated by Chavez' recent proclamations. The increase in the parallel rate has not been lost on BRV officials. The President of the Institute for the Defense and Education of the Consumer (INDECU) recently noted that the government needed to prevent importers from pricing their goods based on the parallel rate and ensure that importers did not profit from parallel rate transactions. The head of SENIAT, Jose Vielma Mora, has also participated in this debate, testifying before the National Assembly that he was concerned about bank profits from currency trading and speculation. On January 26, Vielma Mora announced the formation of a commission comprised of SENIAT, CADIVI, INDECU and the Public Ministry to combat the commercialization of profits from the parallel market trade. Plans include fines and jail times for those that "perturb" the country's "financial peace."

COMMENT

18. (SBU) Currency restrictions are contributing to inflation and shortages (the most recent victims are car manufacturers who cannot import all of the parts needed to assemble a car) that hurt the average Venezuelan. The proposed restriction of foreign exchange and growth in the parallel market could be intentional and a means of creating a dual exchange rate mechanism. "Preferential goods," including raw materials, capital goods, and foodstuffs not produced in Venezuela, can be imported at the better 2150Bs./dollar and the rest at 4200Bs./dollar, which in essence now serves as a 100 percent sin tax on the Venezuelan consumer.

CARACAS 00000216 003 OF 003

19. (SBU) True to BRV form, Chavez' rantings televised on "Alo Presidente" on Sunday, January 21 are becoming government policy. By increasing the tax burden on Venezuelans, Chavez believes that he can capture an even greater role for the state and encourage certain types of consumption. While a tax on individuals with USD 260,000 in assets will only affect a small portion of the population, other taxes on widely used goods like gasoline and cigarettes will hurt the middle and lower classes disproportionately. At the moment, all of these proposals remain that, merely proposals, but given Chavez' propensity for doing as he says and the upcoming Enabling Law, which will allow him to draft and enact legislation without even cursory oversight (or time to rethink potential mistakes), it seems likely that the fence around the private sector will continue to tighten, to the detriment of most Venezuelans.

BROWNFIELD